NO. 86552-3

IN THE SUPREME COURT
OF THE STATE OF WASHINGTON

In re:

BOND ISSUANCE OF GREATER WENATCHEE REGIONAL EVENTS CENTER PUBLIC FACILITIES DISTRICT,

---

GREATER WENATCHEE REGIONAL
EVENTS CENTER PUBLIC FACILITIES DISTRICT

Appellant,

v.

CITY OF WENATCHEE, WASHINGTON and MICHAEL J. WALKER, TAXPAYER REPRESENTATIVE,

Respondents.

BRIEF OF RESPONDENT CITY OF WENATCHEE

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I. INTRODUCTION

This case presents the narrow, fact-specific question of whether a municipality would incur debt within the meaning of Article VIII of the Washington Constitution by absolutely and unconditionally obligating itself to loan money to an unprofitable public facilities district to make debt service payments on such district's bonds where it appears the loans likely will never be repaid. This case does not call into question, generally, the ability of a municipality to loan money to another public entity. Nor does this case call into question the general premise that a municipality does not incur debt within the meaning of Article VIII of the Washington Constitution where the debt is dependent upon the occurrence or non-occurrence of future events, *i.e.*, where the debt is "contingent." Instead, this case asks how contingent that debt must be before it can no longer be considered truly contingent so as to avoid the constitutional and statutory limitations upon debt.

The City of Wenatchee (the "City") did not attempt to answer this question in the trial court proceedings, and it will not attempt to do so now. The City submits this brief for the limited purpose of ensuring that a decision is reached based on a legally and factually complete record.

II. COUNTERSTATEMENT OF THE CASE

A. Nature of the Case

This was a declaratory judgment action by the City under RCW Ch. 7.25. The City sought declarations from the Court to determine whether it would exceed its constitutional and statutory debt capacity were it to execute an agreement to provide financial support for a bond issuance by the Greater Wenatchee Regional Events Center Public Facilities District (the "District").

B. Factual Background

1. Overview

The City made a contractual commitment in 2006 to pledge its full faith and credit to the repayment of certain bonds to be issued by the District to repay the District's outstanding debt used to acquire the Greater Wenatchee Regional Events Center (the "Regional Events Center"). Consistent with that commitment, the District in 2011 presented the City with an agreement that would obligate the City to provide security for bonds to be issued by the District to repay short term notes issued by the District in 2008 to acquire the Regional Events Center (the "Bonds"). The City's obligation would be to make loans to the District should the Regional Events Center's revenues and the tax receipts collected by the District prove insufficient to cover debt service payments on the Bonds.

The City's "debt capacity," measured as a percentage of the value of the taxable property of the City, may not exceed a total of 2.5 percent for general purposes of which up to 1.5 percent may be approved by the City Council without a public vote. *See* RCW 39.36.020(2). The amount of money the City may be required to loan to the District pursuant to the agreement presented by the District could exceed the City's non-voted debt capacity.

2. The Interlocal Agreements

The City, together with the City of East Wenatchee, the City of Cashmere, the City of Chelan, the City of Rock Island, the City of Entiat, the Town of Waterville, Chelan County and Douglas County, formed the District through an interlocal agreement in June 2006. CP 150-164. The City and the District thereafter entered into a separate interlocal agreement on September 6, 2006 (as subsequently amended, the "September 2006 Interlocal Agreement"), CP 166-172, which they thereafter amended on two separate occasions, CP 174-175, 177-179.

In the September 2006 Interlocal Agreement, the City agreed to enter into a contingent loan agreement with the District "to provide security for all or a portion of the bonds to be issued by the PFD to finance the Regional Events Center" and that such contingent loan agreement shall provide that, in the event that the District has insufficient amounts

available from sales taxes and from Regional Events Center revenue, to provide for the timely payment of principal of and interest on such bonds, the City shall "pay the portion of the principal of and interest on such bonds not covered by such taxes or income. The City shall pledge its full faith and credit to the repayment of such bonds." CP 168-169, § 2(B)(1)(e).

3. Financing of the District

In November 2008, the District issued Limited Sales Tax Bond Anticipation Notes, Series 2008 (the "Sales Tax Notes") in the amount of $5,135,000 and its Revenue and Special Tax Bond Anticipation Notes Series 2008A and 2008B (Taxable) (the "the Revenue Notes") in the amount of $36,635,000. CP 147, ¶ 5. These notes were issued, instead of long-term bonds, to acquire the Regional Events Center because of the condition of the bond market at the time. The Sales Tax Notes and the Revenue Notes matured and became due on December 1, 2011. CP 147, ¶ 5.

Pursuant to the September 2006 Interlocal Agreement, the City and the District entered into a Contingent Loan Agreement relating to the Notes on November 13, 2008 (the "November 2008 Contingent Loan Agreement"). CP 181-194. The City agreed to support the Revenue Notes by lending money to the District if necessary to pay interest (but not

principal) on the Revenue Notes. The District did not request, and the City did not enter into, a contingent loan agreement in connection with the Sales Tax Notes. Because the November 2008 Contingent Loan Agreement explicitly provided that any such loans would be limited to the amount of the City's non-voted debt capacity, the November 2008 Contingent Loan Agreement did not cause the same debt capacity concerns that led to these proceedings. Also, at the time the City entered into the November 2008 Contingent Loan Agreement, the City did not have the benefit of the operational history for the Regional Events Center that would later demonstrate the District's need to borrow from the City and the District's inability to repay such loans.

The Regional Events Center has lost money throughout its existence. As a result, the City loaned the District $230,000 in 2009, CP 674, ¶ 3, $1,591,681.20 in 2010, CP 675, ¶ 4, and $795,840.63 in May 2011 to pay interest due on the Revenue Notes, CP 675, ¶ 5. As of the date of the trial court hearing, the City anticipated that it would make an additional loan to the District in November 2011 of $795,840.63. CP 675, ¶ 5.

On June 28, 2011, the District presented the City with a draft of a contingent loan agreement that would require the City to provide support for the Bonds (the "2011 Interlocal Agreement.") CP 198-214. The

City's commitment under the 2011 Interlocal Agreement would be an "absolute and unconditional" obligation to make loans to the District for the payment of principal and interest on the Bonds issued to repay the Revenue Notes if Regional Events Center revenues continued to be insufficient to make debt service payments. CP 203, § 1.01(f).

4. The City's "debt capacity"

Under Article VIII, § 6 of the Washington State Constitution and RCW 39.36.020, the City may issue general obligation bonds in an amount not to exceed 2.5 percent of the assessed value of all taxable property within the City. Unlimited tax general obligation bonds require an approving vote, and any election to authorize such general obligation bonds must have a voter turnout of at least 40 percent of those who voted in the last State general election. Of those voting, 60 percent must vote in the affirmative. The City Council may, by ordinance, authorize the issuance of limited tax general obligation bonds in an amount, including all other limited tax debt of the City, not to exceed 1.5 percent of the assessed valuation within the City without a vote of the people. No combination of limited or unlimited tax bonds may exceed 2.5 percent of the City's assessed valuation.

The City's debt capacity as of the September 8, 2011 trial court hearing, defined by statute as 2.5 percent of the City's assessed valuation,

was approximately $59 million. CP 676, ¶ 9. The debt capacity remaining after accounting for outstanding debt and available assets equaled approximately $25.5[1] million in non-voted debt and approximately $43 million in total debt with a vote. CP 676, ¶ 9.

The best information available to the City at the time of the September 8, 2011 trial court hearing indicated that the principal and interest on the Bonds could range between approximately $65,000,000 (reflecting payments of principal of $37,905,000 and interest of $26,614,197) if the Bonds mature in 20 years and approximately $85,000,000 (reflecting payments of principal of $37,930,000 and interest of $46,823,347) if the Bonds mature in 30 years. CP 677, ¶ 10. If the District continued to rely on the City for loans to make all debt service payments, the City's loan obligation under the 2011 Interlocal Agreement would equal the full amount ($65,000,000 - $85,000,000) of such payments by the District. *Id.*

5. The City maintained its commitment to comply with its contractual and legal obligations

The City will exceed its debt capacity if it executes the 2011 Interlocal Agreement and if its proposed obligations thereunder constitute a debt subject to those statutory and constitutional limits. CP 677, ¶ 11.

[1] The City estimated $23 million prior to the summary judgment hearing; that number was updated on the record at the hearing to approximately $25.5 million. RP 5.

Although the City approved the form of the 2011 Interlocal Agreement, it recognized that it could not enter into the agreement without a judicial determination regarding whether it has the right and the authority to do so. CP 216-234.

6. Bondholder recourse to achieve repayment of the Bonds from City resources

The June 15, 2006 Interlocal Agreement creating the District contains language limiting recourse against the City:

> All liabilities incurred by the District shall be satisfied exclusively from the assets, credit, and property of the District, and no creditor or other person shall have any right of action against or recourse to the parties [to the Interlocal Agreement], their assets, credit, or services, on account of any debts, obligations, liabilities or acts or omissions of the District.

CP 154, § 8. The District's charter similarly contains language prohibiting it from creating any liability that would allow recourse to the assets of the District's members. CP 281, § 5.2. These provisions, however, may be of limited benefit to the City.

a. Bondholders' direct recourse

The District's bondholders' recourse against the City is limited to enforcement of the City's obligation to make loans to the District for payment of debt service on the Bonds, but the bondholders can do so because the 2011 Interlocal Agreement specifically grants them third-party beneficiary status. CP 204, § 1.01(g) and CP 212, § 6.06.

b. Limited scope of non-recourse provisions

The June 15, 2006 Interlocal Agreement's non-recourse provision is limited to obligations incurred "on account of any debts, obligations, liabilities or acts or omissions of the District" CP 154, § 8 (emphasis added). This arguably would not apply to the City's obligations under the 2011 Interlocal Agreement because the City would be assuming an obligation on its own account to make loans to the District. CP 203, § 1.01(f). Similarly, the non-recourse provision in the District's charter - preventing the District from creating a liability that would allow recourse to the assets of its members if it does so "without the written consent of such member", CP 281, § 5.2(B) – could be of limited value because the City's execution of the 2011 Interlocal Agreement may constitute the required "written consent" of the City.

C. Proceedings Below

The City filed a Complaint in Chelan County Superior Court under Chapter 7.25 RCW seeking a judicial determination whether execution of the 2011 Interlocal Agreement would cause it to exceed its debt capacity. CP 92-145 The District was granted leave to intervene, CP 89-91, and a taxpayer representative was appointed, CP 87-88.

The City and the District each moved for summary judgment and the taxpayer responded to each motion. The District requested that the

Court find that the City's obligations under the 2011 Interlocal Agreement would not constitute a "debt" of the City, CP 509-544, and the Taxpayer Representative requested a finding that it would constitute a "debt" of the City, CP 682-709. The City took a neutral position and helped frame the issues for the Court. CP 722-753. The Court ruled on the summary judgment motions and entered an order on the issues identified by the City. CP 663-65. The District sought and was granted direct, expedited review by this Court.

III. STANDARD OF REVIEW

Orders granting summary judgment are reviewed *de novo*. *Kelley v. Centennial Contractors Enters., Inc.*, 169 Wn.2d 381, 386, 236 P.3d 197 (2010).

IV. AUTHORITY

A. The Trial Court Considered Whether The City's Loans Under The 2011 Interlocal Agreement Could Constitute A Debt Of The City

1. The question before the trial court was whether the City would become indebted and not whether the City would be required to borrow money

The District contends that municipal debt subject to constitutional and statutory limits is limited to "borrowed money." In support of this position, the District relies upon cases decided under Article VIII, § § 1, 2, and 3 (relating to state debt) and not under Article VIII, § 6 (relating to

municipal debt). For example, the Court in *State ex rel. Wittler v. Yelle*, 65 Wn.2d 660, 668-69, 399 P.2d 319 (1965) stated:

> The court has many times said what Article 8 means by the word "debt." We think it means borrowed money; it denotes an obligation created by the loan of money, usually evidenced by bonds but possibly created by the issuance of paper bearing a different label .... We know of no cases decided by us since statehood in which we have held ***Art. 8, Secs, 1,2 and 3*** applicable to other than borrowed money.

Id. at 668, 670. (Emphasis added.) *See also State ex rel. Troy v. Yelle*, 36 Wn.2d 192, 217 P.2d 337 (1950) ("It is our interpretation that 'debt,' within the purview of Art. VIII, §§ 1, 2 and 3, is borrowed money and not warrant obligations for the payment of the current expenses of the state government such as services rendered and materials furnished.")

These two constitutional provisions define debt differently depending on whether the debt belongs to the state or to a municipality:

Wash. Const. Art. VIII, § 1. "State Debt"	Wash. Const. Art. VIII, § 6. "Limitations upon municipal indebtedness"
(d) In computing the amount required for payment of principal and interest on outstanding debt ***under this section, debt shall be construed to mean borrowed money*** represented by bonds, notes, or other evidences of indebtedness which are secured by the full faith and credit of the state or are required to be repaid, directly or indirectly, from general state revenues... (emphasis added).	No county, city, town, school district, or other municipal corporation ***shall for any purpose become indebted in any manner*** to an amount exceeding one and one-half per centum of the taxable property... (emphasis added).

Thus, while the cases cited by the District were decided under an express constitutional definition of state debt as "borrowed money," the question before the trial court was whether the City, as a municipality, shall "for any purpose become indebted in any manner" by assuming the obligations in the 2011 Interlocal Agreement. The trial court had no clear precedent for answering that question, as recognized by the Attorney General:

> In the case of *State ex rel. Troy v. Yelle*, 36 Wn. (2d) 192, 217 P. (2d) 337, our supreme court held that the term "debt" as it is used in sections 1, 2 and 3 of Article VIII of the constitution, refers only to borrowed money and not to warrant indebtedness. Sections 1, 2 and 3 relate to state debts and the holding is arrived at by a discussion of other sections of the constitution pertaining to state indebtedness. ***It is, therefore, uncertain whether the court would extend that holding to section 6, Article VIII, pertaining to municipal debts***, and hold that warrant indebtedness does not bring a municipality within the debt limit prescribed by section 6, Article VIII of the constitution.

1951-1953 Op. Atty Gen. Wash. No. 345; *see* 1952 Wash. AG LEXIS 393. The AG consequently recommended the uncertainty be resolved by judicial determinations, precisely as done by the City[2]:

> ... we do not believe that the auditor may safely continue to issue warrants for indebtedness in excess of the constitutional debt limit unless the matter shall have been passed upon by a court. It is our suggestion that

[2] At pages 22-23 of its brief, the District suggests that, rather than seek a judicial determination on the issue of whether the loans would constitute a debt, the City should have accepted the position of the Foster Pepper PLCC attorneys who represented the District. As those attorneys represented the District, any advice given to the City is the product of an inherent conflict of interest, and the City should not be questioned for having sought the opinion of an independent court.

> arrangements should be made to submit the matter at an early date to the superior court.

Id.

This "uncertainty" continues to exist today because no Washington court has been asked to apply the Section 1 definition of state debt as "borrowed money" to Section 6 municipal debt. To the contrary, other Washington municipal debt cases apply "shall for any purpose become indebted in any manner" in a broader sense than "borrowed money." For example, in *Comfort v. City of Tacoma*, 142 Wash. 249, 252 P. 929 (1927) and *Kelly v. City of Sunnyside*, 168 Wash. 95, 11 P.2d 230 (1932), the courts considered whether the City "became indebted" through its obligation to pay into a guaranty fund and to levy taxes to make those payments. There, although the courts concluded that the City had not "become indebted" because the debts were contingent, the courts did not incorporate the "borrowed money" definition into the separate municipal standard of "become indebted in any manner."

Having been asked to determine whether the City would "become indebted in any manner" under the 2011 Interlocal Agreement, the trial court properly did not limit its consideration to whether the City would be required to "borrow money" to satisfy its obligation.

2. The trial court considered whether the City would "become indebted in any manner" by making loans to the District

The trial court was asked to look beyond the label of the City's commitments as loans to determine the true impact of the City's obligations. This is the approach suggested in the leading treatise, *Municipal Debt Finance Law*, where the authors describe the relationship between debt and risk of loss. *See* Robert S. Amdursky and Clayton P. Gillette, Debt Finance Law § 4.1.1, 160-161 (Little, Brown and Co., 1992 & Supp. 2002) (*see also Dep't of Ecology v. State Fin. Comm.*, 116 Wn.2d 246, 254, 804 P.2d 1241 (1991) (finding that no debt was incurred in part because the risk of loss was on the investors and not the state)). Analyzing Washington "debt" cases, the authors concluded that Washington courts recognize risk of loss as an important consideration in determining whether a debt is incurred:

> If a project's failure immunizes the public treasury from further payments to bondholders, the concerns that motivated adoption of the limits are not triggered. If bondholders can reach the public treasury notwithstanding the absence of any commensurate benefit for the issuer's constituents, then the very concerns that underlie the debt provisions arise.

Amdursky and Gillette at 169. *See also State v. Yelle*, 47 Wn.2d 705, 715, 298 P.2d 355 (1955) (requiring the court to "strip the plan down to fundamentals" to determine if it implicates debt limitations).

The 2011 Interlocal Agreement provides that "the City agrees to make Loans to the District hereunder regardless of whether the Regional Events Center is operating at any particular time." CP 203, § 1.01(f). Accordingly, were the City to execute the 2011 Interlocal Agreement, the City would be obligated to loan money to the District even if the Regional Events Center ceased operations. In short, the risk of failure of the Regional Events Center would fall upon the City. The District, or the District's bondholders as third-party beneficiaries, could sue the City to force it to make loans to the District. CP 204, § 1.01(g) and CP 212, § 6.06. And, because the loans are made to compensate for a shortfall in Regional Events Center operational and tax revenues, there is a very real chance the loans would never be repaid. CP 674-681.

The trial court properly considered these possibilities when looking past the over-simplified labels advocated by the District.[3]

3. The trial court considered whether an "intergovernmental" loan inherently prevents the lender from becoming indebted

The result does not change, as the District suggests, simply because the loan is between governmental entities. Instead, Washington courts still look to chances of repayment and the potential impact on the

[3] In other circumstances, where the State has committed to make loans from its general fund, the Court has assumed such commitments to be debts subject to constitutional restrictions. *See, e.g., State ex rel. State Capitol Com v. Lister*, 91 Wash. 9, 156 P. 858 (1916) (provision allowing State to levy taxes to pay interest on bonds with the payments of interest to be considered a loan subject to repayment from the State's general fund).

municipality's general fund. For example, in *Griffin v. Tacoma*, the court concluded that where the city makes temporary loans from its general fund to other funds which have an assured and certain source of income, the collection of which is under the control of the city, such loans do not imperil the general fund. *Griffin*, 49 Wash. 524, 95 P. 1107 (1908). These loans, thus, are not to be considered in determining the obligations of the city, for the reason that the fund, out of which the temporary loan is to be paid, is the equivalent of cash as a working asset. *See also Seymour v. Ellensburg*, 81 Wash. 365, 142 P. 875 (1914).

Unlike in *Griffin* and *Seymour*, the City's loans under the 2011 Interlocal Agreement are not accompanied by an assured and certain source of income, nor is the collection of repayment under the City's control. *See State ex rel. State Capitol Comm. v. Lister*, 91 Wash 9, 17, 156 P. 858 (1916) (distinguishing *Griffin* and *Seymour* as finding loans to not be debt only because of the guaranteed source of repayment). Although the District suggests that the 2011 Interlocal Agreement "incorporates a number of protections to ensure that the District has sufficient funds available to repay any loans" (Appellant's Brief, p. 12), none of the "protections" cited by the District give rise to the degree of "legal certainty" necessary for the City to treat the loans as assets. For example, although the District may seek to increase taxes, doing so

requires it first to obtain permission from its eight other municipality members and then to obtain approval from the members' individual voters. CP 154, § 7.3. Both the municipalities and the individual voters retain the right to reject the District's request. *Id.* Similarly, although the District may see increased revenues in the future, such a possibility does not equate to a certainty (particularly where all evidence points to the District's continued inability to repay the loans). Finally, although the District is obligated to continue to impose taxes for so long as loan repayment obligations to the City remain outstanding, the statutory sales and use tax expires in July 2031 – before 30 year Bonds issued by the District would mature and, accordingly, before the City loans would be repaid. CP 205, § 1.02(d).

For all of these reasons, the State Auditor required the City to note in its financial statements that the uncertainty of repayment of the loans prevented the City from treating the loans as a future receivable for the City. CP 846 -850.

4. The trial court considered the impact of the source of the funds on whether the City's obligation would constitute a debt

The District argues at pages 39-42 of its brief that no debt is created in part because the City has no obligation to fund the loans from any specific source. In making this statement, the District overlooks the

"absolute and unconditional" obligation of the City under the 2011 Interlocal Agreement to make loans to the District. CP 203, § 1.01(f). In addition, because the 2011 Interlocal Agreement supersedes provisions of the September 2006 Interlocal Agreement only if and to the extent of any conflict between those provisions, CP 213, § 6.10, the City's obligations under the 2011 Interlocal Agreement could include a pledge of its full faith and credit as provided for in the September 2006 Interlocal Agreement.

Due to the nature of these obligations, if the City's "reserves, current taxes, or other resources" provide insufficient resources to make the loans, just as in *Comfort*, the City would be required to raise taxes, or "borrow" money, to the extent permitted by law to meet its obligations. CP 774, ¶ 3.

B. The Trial Court Considered Whether The City's Obligations Under The 2011 Interlocal Agreement, If Debt, Would Be Subject To The Contingent Debt Exception

Washington courts have created exceptions under which a debt nonetheless does not constitute a "debt" subject to debt capacity limits. *See, e.g., Winston v. Spokane*, 12 Wash. 524, 41 P. 888 (1895) (establishing "special fund doctrine" exception for obligations payable from a special fund and solely from anticipated service revenue); *Comfort v. Tacoma*, 142 Wash. 249, 252, P. 929 (1927) (recognizing "contingent

debt" exception for debt that will only be incurred upon the happening of some predetermined event); *Department of Ecology*, 116 Wn.2d 246 (recognizing "subject to appropriations exception" for debt that is neither backed by a pledge of full faith and credit nor an obligation to appropriate funds for repayment).

The only exception at issue in this appeal is the contingent debt exception. Under the 2011 Interlocal Agreement, the City must loan money to the District, but only if and when the District lacks the means to repay the Bonds on any payment date. CP 203, § 1.01(f). The District has demonstrated repeatedly that it does not have the independent ability to service its current debt either from operating revenue or the imposition of additional taxes. 674-675, ¶ ¶ 3-5. Because of that inability, the 2011 Interlocal Agreement explicitly acknowledges that the Bonds cannot be marketed without the security provided by the City. CP 204, § 1.01(g). The question considered by the trial court, then, was whether the City's obligation to loan the District money is truly "contingent" within the meaning of the debt exception.

"The contingent liability doctrine is confusing and cannot easily be put into some sort of standard." *State ex rel. City of Charleston v. Hall*, 190 W. Va. 665, 670, 441 S.E.2d 386 (W. Va. 1994). "In common, ordinary and everyday usage and in dictionaries, the word 'contingent' is

defined to mean: possible but doubtful or uncertain; unpredictable because affected by unforeseen conditions or dependent on something that may or may not occur." *Button v. Day*, 205 Va. 629, 642, 139 S.E.2d 91, 100 (1964). According to the leading municipal law treatise addressing the subject:

> Merely incurring a contingent future liability does not create indebtedness. Thus, a contract to pay a fixed price annually, where contingent on the supply furnished, does not create indebtedness. But it is held in some jurisdictions that a debt payable upon a contingency, as upon the happening of some event, such as the rendering of service or delivery of property, is no less a debt, and therefore, within the constitutional prohibition.

15 McQuillin § 41.23 (footnotes omitted).

In *State Capitol Comm. v. State Bd. of Finance*, the State guaranteed payment of principal and interest on the Capitol Building Construction Bonds. *See State Capitol Comm.*, 74 Wash. 15, 132 P. 861 (1913). Even though there appeared to be ample revenues available to discharge the bonds from the sale of public lands making the likelihood of state payment remote, the Court concluded:

> . . . notwithstanding the possibility and even probability that the obligation sought to be so incurred will be eventually liquidated by funds derived from the sales of the capitol land, and thus the burden be entirely removed from the taxpayers, they must nevertheless be regarded as general state bonds for the purpose of investing the general school fund therein. They cannot be regarded as such, in our opinion, without violating both the spirit and the letter

of the sections of article 8 of the state constitution above quoted.

Id. at 27.

This Court again addressed the contingent debt exception fourteen years later in *Comfort v. Tacoma.* 142 Wash. 249. There, the city of Tacoma attempted to guarantee its local improvement bonds through a guaranty fund created from a tax levy of special assessments on the benefited property. Upon challenge, the Court concluded that the guaranty fund constituted a contingent liability:

> Specific provision is made by § 5 of the act that no holder of any bond shall have any claim whatsoever by reason of said bond against the city, except the right to payment from the special assessments collected and the guaranty fund. The question then naturally arises; has the city unconditionally bound itself to pay all these unpaid bonds to the extent of at least five per cent of the total amount outstanding? It is apparent, of course, that the city has made no such promise. Its promise is to pay into the guaranty fund sufficient to make it equal to five per cent of the outstanding bonds, provided the local assessment funds prove insufficient. To state the matter more simply, the city agrees that if the property holders, whose property has been assessed for the improvement, fail to pay in the regular assessments to cover the bonds when due, then the city will make payment for them to a certain extent by accepting the bonds from the holders and levying a tax for the money to pay the same. This will readily be seen to be only a contingent liability as far as the city is concerned, and in no sense a debt proper.
>
> If A is indebted to B and C promises that, if A does not pay B, then he (C) will, no one would contend that C had an outstanding debt. He has but a contingent liability that may or may not ripen into a debt. If A fails to pay, then, in that

> event, the contingent liability has ripened and the debt is absolute as to C. But until that time arrives C owes B nothing.
>
> So in the present case, the city will have nothing to pay if the property-holders meet their obligations and pay their assessments. If they fail to do so, then the city will pay into the fund to the extent outlined in the statute.
>
> The distinction between a debt and a contingent liability is nowhere more concisely stated than in *Walla Walla v. Walla Walla Water Co.*, 172 U.S. 1, 43 L. Ed. 341, 19 S. Ct. 77:
>
> > 'There is a distinction between a debt and a contract for future indebtedness to be incurred, provided the contracting party perform the agreement out of which the debt may arise. There is also a distinction between the latter case and one where an absolute debt is created at once, as, by the issue of railway bonds or for the erection of a public improvement, -- though such debt be payable in the future by installments. In the one case the indebtedness is not created until the consideration has been furnished; in the other the debt is created at once, the time of payment being only postponed.'
>
> Applying this rule to the present case it will be seen that the consideration will not be furnished until the bondholders deliver to the city the bonds against the property for which the special assessments were levied. Upon the delivery, then the city will pay the money into the guaranty fund.

Id. at 255-256 (internal numbering omitted); *accord Kelly v. City of Sunnyside*, 168 Wash. 95, 11 P.2d 230 (1932).

From this discussion, *Comfort* is often cited for the general proposition that a debt is not created where it is "only a contingent liability as far as the city is concerned." *Id.*, 142 Wash. at 255. However, the

Comfort court did not discuss the *State Capitol Comm.* decision. Subsequent Washington cases have likewise failed to define the line between a contingent debt under *Comfort* and a constitutionally proscribed debt under *State Capitol Comm.* Reconciling these cases requires careful consideration of the distinguishing characteristics of the particular debt at issue. For example, *Comfort* found the city's obligation "contingent," because the Legislature created restrictions aimed at ensuring that the assessments would be adequate such that the guaranty fund need not be used:

> Whether the legislature has adopted the proper limitations to bring about a condition where no district will fail to produce sufficient amount, either by voluntary payment or foreclosure, to pay all the bonds without any loss whatever accruing to the guaranty fund, is a matter that time alone can show. That is a matter to be left to the wisdom of the legislature, and we can not and will not assume that the purposes it had in mind will fail of attainment. ***Rather will we assume that the results anticipated will be realized until the contrary clearly appears.***

Id., 142 Wash. at 258-259 (emphasis added). This Court thus recognized that a contingent debt could count against the debt capacity where it "clearly appears" that "the results anticipated," *e.g.*, sufficient District revenues to make its debt service payments, will not be realized. The likelihood of the contingency occurring again factored into this Court's application of the contingent debt exception:

> Only in the event that (1) the LID assessments on real property within the LID fail to yield sufficient funds to pay for the project, and (2) foreclosure of the assessment liens fails to realize an amount of money equal to the assessment, and (3) exercise of subrogation fails to realize amounts disbursed from the guaranty fund, does the LID guaranty fund ultimately respond with any money from the city's general fund. The law would not describe so unlikely and contingent a use of the general fund as employment of taxation lacking uniformity.

Berglund v. Tacoma, 70 Wn.2d 475, 480-481, 423 P.2d 922 (1967). These decisions thus demonstrate that not all "contingent" debts are exempted. Rather, courts consider the degree to which the debt is contingent and whether, under all the facts presented, the obligation could be construed as an indebtedness.

Other jurisdictions reflect a diverse approach to the contingent debt exception. For example, the Virginia Supreme Court looks beyond the description of a debt as "contingent" and examines the practical impact of the obligation at issue. In *Button v. Day*, the court considered an agreement for the lease and operation of the port facilities between the City of Newport News, the Peninsula Ports Authority of Virginia and the Chesapeake & Ohio Railway Company. *Button v. Day,* 205 Va. 629, 139 S.E.2d 91 (1964). The agreement provided that the authority would 'urgently request' appropriations equal to 50 percent of the annual amortization of the authority's bonds; in the absence of such

appropriations, the city would pay such amount. Recognizing a conflict of authority on the issue, the court held that the city assumed a debt because it agreed to be primarily liable for payments of the authority's bonds:

> Whether an obligation is contingent or not is to be determined by the terms of the provision creating the obligation, and not by a label placed upon it. It is manifest from the provisions of the Enabling Act and from the recitals in the preamble of the Memorandum of Agreement that it was thought bonds of the Authority could not be issued and marketed without the additional security of pledged money from the City. Therefore, 'in order to facilitate the issuance and marketing' of its bonds, the City agreed, in consideration of the subsequent conveyance of the properties of Authority to it, to assume the payment of an amount not exceeding the rental paid by the Railway lessee, whether or not the Authority received appropriations from the State or from other sources.
>
> The obligation of the City to the Authority is certain. Its enforceability is not dependent upon uncertain or unpredictable appropriations from the State or other sources. As we have seen, the City agrees to pay the obligation 'notwithstanding' the failure of the Authority to receive a grant of funds from any source. Thus, the City assumes the risk involved, not the Authority nor the prospective purchasers of Authority's bonds.
>
> We hold that under the Memorandum of Agreement, the City will become primarily and absolutely liable, and that its liability is not changed by the mode of payment and it is immaterial whether the bonds be paid out of its own revenues or from funds derived from other sources. The City's obligation to pay at all hazards and the possibility that the Authority may receive appropriations from the State do not militate against the fact that the City will directly assume an obligation in excess of constitutional and statutory provisions.

Id. at 642 (internal numbering omitted). *See also Board of Supervisors of Fairfax County v. Massey*, 210 Va. 253, 261, 169 S.E.2d 556 (1969) (pledge to pay deficits of local transit authority held to be debt despite lack of present deficit because it was apparent payments would be required).

The Arizona Supreme Court confronted issues similar to those in *Massey* and reached an identical result in *Tucson Transit Auth., Inc. v. Nelson*, 107 Ariz. 246, 250, 485 P.2d 816, 820 (1971). There, the court explained that because "it is common knowledge that municipal transit systems are financially a losing proposition," the pledge of the city of its taxing power made the underyling agreement a constitutionally proscribed debt even though "it may be true that a large portion of the maintenance and operational expenses may be paid from funds generated by the operation of the Transit Authority." *Tucson Transit*, 107 Ariz. at 249.

The Supreme Court of Iowa provides an example of a court on the other end of the spectrum from Virginia and Arizona. In *Fults v. City of Coralville*, 666 N.W.2d 548 (Iowa 2003), the court held that: "[c]onstitutional debt exists only when it appears such contingency is sure to take place irrespective of any action taken or option exercised by the city in the future." *Id.*, 666 N.W.2d at 556-557.

The trial court faced a difficult task in trying to apply the contingent debt exception without clear judicial guidance. While *Comfort*

is often cited as the leading Washington case on the subject, it did not squarely address the question here presented — what happens when "the city [has] unconditionally bound itself to pay all these unpaid bonds...?" *Comfort,* 142 Wash. at 255. The trial court grappled with that question because the 2011 Interlocal Agreement would require the City to "unconditionally" bind itself to repayment of the Bonds despite any lack of certainty of repayment:

> The City's obligations to make loans to the District in the amounts, at the times and in the manner described herein shall be absolute and unconditional, and shall not be subject to diminution by setoff, counterclaim, abatement or otherwise. The City agrees to make loans to the District hereunder regardless of whether the Regional Events Center is operating at any particular time.

CP 203, § 1.01(f). To comply with this obligation, the City would need to reserve funds each year to make loans to the District, but would be unable to similarly budget for the uncertain repayment of those loans. The trial court therefore concluded that this commitment of the City was not sufficiently contingent to bring it within the contingent debt exception.

C. The Trial Court Considered Whether The "Debt," If Any, Includes Principal And Interest, or Principal Only

The Washington Constitution, Art. VIII, § 1, appears to define state "debt" to include both principal and interest:

> (b) The aggregate debt contracted by the state shall not exceed that amount for which payments of principal and interest in any fiscal year would require the state to expend

> more than nine percent of the arithmetic mean of its general state revenues for the three immediately preceding fiscal years as certified by the treasurer.
>
> ...
>
> (d) In computing the amount required for payment of principal and interest on outstanding debt under this section, debt shall be construed to mean borrowed money represented by bonds, notes, or other evidences of indebtedness which are secured by the full faith and credit of the state or are required to be repaid, directly or indirectly, from general state revenues . . . but shall not include obligations for the payment of current expenses of state government . . . .In addition, for the purpose of computing the amount required for payment of interest on outstanding debt under subsection (b) of this section and this subsection, "interest" shall be reduced by subtracting the amount scheduled to be received by the state as payments from the federal government in each year in respect of bonds, notes, or other evidences of indebtedness subject to this section.

However, there is competing authority that suggests that, for the purposes of calculating municipal "debt" for debt limit purposes, only the principal obligation counts towards the limit. For example, 15 McQuillin § 41.27 provides that:

> interest is not a debt, within the meaning of debt-limit provisions, until it is earned and becomes due, and in determining whether an indebtedness will be created in excess of the debt limit, unearned interest can not be added to the principal. The authority granted by the constitution or statute to contract a debt refers to the amount of the debt at the date at which it is created and has no reference to the amounts of interest which accrue thereafter. On the other hand, interest which has become due and payable is a part of the existing indebtedness in figuring the total amount of municipal indebtedness.

This Court recognized, in *State ex rel. State Capitol Comm'n v. Lister*, the lack of a uniform answer to the question:

> Our attention has been directed to a number of authorities holding that the interest to accrue upon municipal bonds is not to be taken into consideration in determining whether such municipality has exceeded its debt limit. And that is the general rule relative to such corporations, *though there are some decisions to the contrary.*

Lister, 91 Wash. at 15 (emphasis added). And, at least for state debt, this Court appears to have assumed that both principal and interest count towards the debt limit. *See, e.g., State Capitol Comm'n v. State Bd. of Fin.*, 74 Wash. 15 (finding the State exceeded its debt limit when it guaranteed payment of principal and interest on the Capitol Building Construction Bonds). The trial court concluded, again without the benefit of clear precedent, that the principal and interest of any City loans under the 2011 Interlocal Agreement would count against the City's debt capacity.

D. The Trial Court Considered When And To What Extent The "Debt," If Any, Would Be Incurred By The City

Were the City to execute the 2011 Interlocal Agreement, it would expose itself to the possibility of having to loan the District up to approximately $85 million over the repayment period for the Bonds. CP 677, ¶ 10. The loans in any given year, obviously, would be much less. The trial court was therefore asked to determine when and in what amount

the City would incur a debt. While this Court has not squarely answered the question under the unique facts presented here, the Washington State Attorney General provided some guidance:

> Would a line of credit or a letter of credit of the type referred to in question 3 constitute a borrowing by the municipal corporation and be subject to limitations on indebtedness and any other constitutional or statutory restraints on borrowing by the municipal corporation in question?
>
> Limitations upon municipal indebtedness are contained, inter alia, in article 8, section 6 of the state constitution, RCW 39.36.020 (limitation on indebtedness of taxing districts generally), RCW 36.67.010 (limitation on indebtedness of counties), and RCW 35.30.040 (limitation on indebtedness of cities). Generally speaking, each of these provisions limits municipal corporations from becoming indebted in amounts exceeding certain percentages of the value of the taxable property in the particular taxing district.
>
> We do not believe either a line of credit or the type of letter of credit arrangement discussed in question 3 would constitute municipal borrowing subject to constitutional and statutory limitations on indebtedness. The rule in Washington, as elsewhere, is that incurring a contingent future liability does not create an indebtedness. *Kelly v. Sunnyside*, 168 Wash. 95, 96-97, 11 P.2d 230 (1932); *Comfort v. Tacoma*, 142 Wash. 249, 253-59, 252 P. 929 (1927); *see also* 15 E. McQuillin, § 41.23, at 423.
>
> In *Comfort*, the court held that local improvement bonds guaranteed by the city of Tacoma were not debts of the city. They were "only a contingent liability as far as the city is concerned, and in no sense a debt proper." 142 Wash. at 255. The court reasoned as follows:
>
> If A is indebted to B and C promises that, if A does not pay B, then he (C) will, no one would contend that C had an

> outstanding debt. He has but a contingent liability that may or may not ripen into a debt. If A fails to pay, then, in that event, the contingent liability has ripened and the debt is absolute as to C. But until that time arrives C owes B nothing. 142 Wash. at 255-56.
>
> A line of credit does not create an obligation to repay until drawn. Therefore, it is a contingent liability rather than a debt subject to limitation. Similarly contingent is the [[Orig. Op. Page 14]] liability of the procurer to the issuer of a letter of credit. The issuing bank authorizes the beneficiary to draw on the letter in accordance with certain terms and conditions. If the letter is drawn upon, then the customer becomes obligated to reimburse the issuing bank. The customer (the municipal corporation) would not pay the issuing bank, however, if the customer met its underlying obligations to the beneficiary (the warrant-cashing bank). The municipal corporation's obligation to the issuing bank therefore would be a contingent liability, rather than a debt subject to limitation.

Wash. AGO 1988 No. 26.

In *Comfort*, the case relied upon by the Washington Attorney General, this Court quoted with approval the following passage from *Walla Walla v. Walla Walla Water Co.*, 172 U.S. 1, 43 L. Ed. 341, 19 S. Ct. 77 (1898):

> There is also a distinction between the latter case and one where an absolute debt is created at once, as, by the issue of railway bonds or for the erection of a public improvement, -- though such debt be payable in the future by installments. In the one case the indebtedness is not created until the consideration has been furnished; in the other the debt is created at once, the time of payment being only postponed.

Comfort, 142 Wash. at 256. The Supreme Court appears to indicate in *Walla Walla* that a debt payable by future installments nonetheless might constitute an immediate, absolute debt. However, because the *Walla Walla* decision did not address whether a commitment to make loans in an unknown amount spread out over a number of years constitutes "an absolute debt...created at once," the trial court was once again left without clear guidance to resolve the issue.

E. The Trial Court's Evidentiary Rulings, In Addition To Being Correct, Did Not Influence The Court's Decision

1. The Piper Jaffray projections

The District did not ask the trial court to exclude Exhibit 1 to the Declaration of Deanne McDaniel from its consideration. Instead, the District states only that "[t]here is serious question whether Exhibit 1...is proper for consideration..." CP 530, n.5. As a result, the trial court did not rule on the admissibility of the exhibit and no error was committed.

Even had the court been asked to rule on the admissibility of Exhibit 1 to the McDaniel Declaration, CP 680-681, it would not have committed error by admitting the document. Ms. McDaniel, who had personal knowledge of the exhibit, provided sufficient authentication "to support a finding that the matter in question is what its proponent claims," namely, a copy of materials received from Piper Jaffray. ER 901. In addition, the document is not hearsay because it was not offered "to prove

the truth of the matter asserted," but rather to show a plausible range of possible Bond payments. ER 801(c). The trial court was not asked to accept Piper Jaffray's projections as "truth"; instead, the document was offered to show that under any conceivable scenario the Bond repayments would exceed the City's debt capacity (if the court first made the predicate findings of "debt") For that reason, it was also relevant to the questions before the court and admissible under ER 402.[4]

2. The Declaration of Steve Smith and the exhibit attached thereto

The trial court admitted the Declaration of Steve Smith and the exhibit attached thereto, CP 846-850, but expressly ruled that the case would not turn on the decision to admit the evidence. RP 51. Mr. Smith, who had personal knowledge of the exhibit, provided sufficient authentication "to support a finding that the matter in question is what its proponent claims," namely an August 25, 2011, e-mail he received from Jean Wilkinson of the Washington Attorney General's Office. ER 901.

In addition, the document is not hearsay because it was not offered "to prove the truth of the matter asserted," but rather to show the impact on the City of the State Auditor's comments. ER 801. For that same reason, the e-mail was relevant because it related to whether the City

[4] The court could have taken judicial notice of anticipated bond payments by calculating the market rates, maturity lengths, etc., but doing so would have been a waste of time because the precise amount of the payments was not at issue.

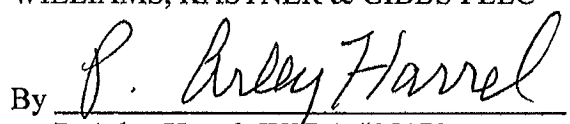
could record a receivable in its financial accounts equal to any loans made to the District. *See* ER 402.

V. CONCLUSION

As recommended by the Attorney General, the City sought judicial guidance to answer the question whether its obligations under the 2011 Interlocal Agreement could cause it to exceed its debt capacity. The trial court struggled with the same lack of certainty that forced the City to file its complaint, but did an admirable job trying to resolve the difficult questions presented. Just as the City stated it would abide by the trial court's decision, so too will the City abide by this Court's decision should it reach different conclusions.

RESPECTFULLY SUBMITTED this 5th day of December, 2011.

WILLIAMS, KASTNER & GIBBS PLLC

By 

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CERTIFICATE OF SERVICE

I hereby certify under penalty of perjury that under the laws of the State of Washington that on the 5th day of December, 2011, I caused a true and correct copy of the foregoing document, "Brief of Respondent," to be delivered in the manner indicated below to the following counsel of record:

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DATED this 5th day of December, 2011, at Seattle, Washington.

Janis Hager, Legal Assistant

OFFICE RECEPTIONIST, CLERK

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Subject: RE: Greater Wenatchee Regional Events Center Public Facilities District v. City of Wenatchee, Washington and Michael J. Walker, Supreme Court Cause No. 86552-3

Rec. 12-5-11

Please note that any pleading filed as an attachment to e-mail will be treated as the original. Therefore, if a filing is by e-mail attachment, it is not necessary to mail to the court the original of the document.

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Subject: RE: Greater Wenatchee Regional Events Center Public Facilities District v. City of Wenatchee, Washington and Michael J. Walker, Supreme Court Cause No. 86552-3

12/05/2011

Dear Clerk of the Court:

On behalf of P. Arley Harrel (WSBA #05170, (206) 628-6625, aharrel@williamskastner.com), attorney for Respondent City of Wenatchee, please find attached in pdf format the following for filing with the Supreme Court, Cause No. 86552-3:

Brief of Respondent City of Wenatchee.

We await your confirming email that this document has been received and filed with the Court.

Thank you in advance for your assistance.

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